Marketing Models for Pork in the Tristate Area: Indiana, Ohio, Michigan

Nine Models for Selling Pork and the Information You Need to Help Make the Right Decision for Your Operation



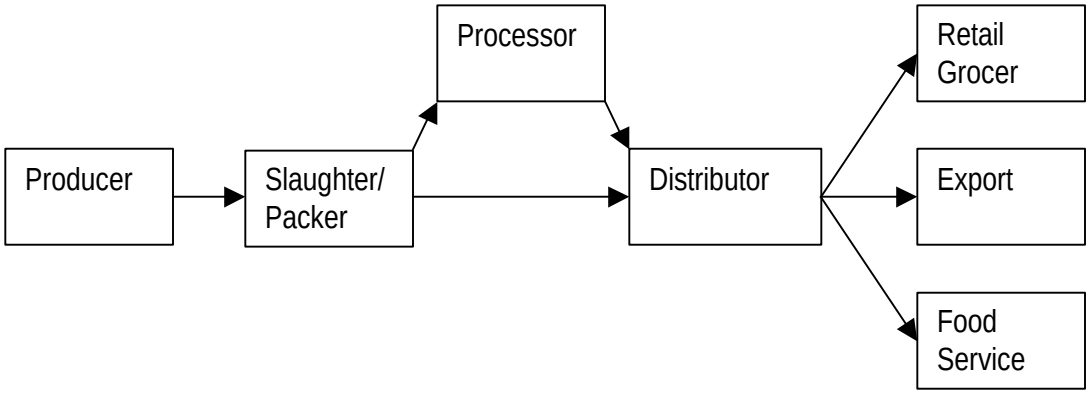

I. Introduction and Background

It is easy to understand why so many hog farmers are discouraged. With prices below break even in 2002 and expectations that prices won't top $0.40/lb. in 2003, many producers are struggling to stay in business. It is also easy to understand why they are frustrated when they see pork for $2.69/lb. in the meat case and know they are only capturing a small portion of that value. [1] It is natural for producers to want a piece of that pie. In an effort to capture more value, many producer groups have an interest in becoming part of coordinated pork foods systems with the hopes of capturing more value and staying in business.

The Tri-state Pork Initiative is sponsored by the Indiana, Michigan, and Ohio Pork Producers Associations with the intention of helping producers and producer groups better understand the pork value chain and what, if any, opportunities exist for producers to capture more value. This guide gives producers a realistic understanding of the very competitive pork industry, and outlines some basic models for becoming part of a pork food system as well as the related hurdles to success. The report includes a basic overview of the pork industry from the farm gate to the consumer, the economics of the current industry, opportunity models for coordinated pork systems, and the results of the research with decision makers throughout the value chain.

The Pork Value Chain

The pork value chain, for the purpose of this discussion, includes all the steps that take place from production to the consumer. It includes production, slaughter/packing function, processing, distributor/wholesaler, retail grocery, food service and export. The following diagram illustrates a simplified version of the physical value chain.



Different business systems utilize any number of configurations of this value chain and there are exceptions to this chain as well. In some cases the processing and slaughter/packing steps occur in the same location. The packer often ships pork direct to the distribution centers for large retail accounts, skipping the distributor/wholesaler step. There are also small meat distribution

[1] 2001 Averages, USDA/ERS Data, www.ers.usda.gov/DataMeatScanner/StandardReports/BLSTable2.htm

companies that sell meat to high-end restaurants in metropolitan areas. Brokers are often involved in selling processed pork products, but don't take possession of the physical product.

Value Chain Economics

The largest increase in value of pork is seen when it hits the retail shelf. Meat is one of the few moneymakers for the retail grocery industry, helping offset the loss they incur on many other items. The percentage of the dollars captured and gross margins (assuming a 250 lb. hog @ $0.40/lb.) are:[2]

		% of dollars captured	Gross Margins
Production	$100	29%	
Slaughter & Carcass Cutting	$22	7%	1-2%
Processing & Packaging	$38	11%	6-8%
Distribution	$25	7%	4-6%
Retail & Food Service	$155	46%	2-10%
Total	$340	100%	

These numbers illustrate an accurate portrayal of a very competitive industry where it is very difficult to differentiate pork product. Pork continues to be largely seen as a commodity by both consumers and players in the pork value chain. The very low gross margins also explain why players at every level of the pork value chain are consolidating so rapidly. With low gross margins, a high volume and low cost are the keys to success.

[2] A study performed for Pork America, the numbers include ten-year averages, assuming a 250 lb. hog and $0.40/lb. live weight price. ABG primary research shows higher gross margins for retailers than the numbers included here in this chart.

II. Approach and Methodology

ABG utilized the following approach for completing this project:

Phase One:

The first phase of this project was the development of a full evaluation of the current trends in pork production and processing in the Tri-State (Indiana, Michigan and Ohio) area. This step included identifying producer trends by type of producer, processing capacity trends, transactional relationship trends and drivers of change in the industry.

In addition, ABG interviewed pork industry experts in the Tri-State area. These interviews were used to project changes between 2001 and 2005 in the pork industry and specifically the Tri-State area. Phase one was completed and a presentation of the results occurred in 2001.

Phase Two:

Phase two of this project was a pre-market assessment of the pork value chain, initial concept development and concept testing. Approximately 12 interviews where completed with retailers and food service companies in the Tri-State area to gain an initial understanding of how the current business models met their needs. The resulting concepts were then tested in three cross-state sessions that included University experts, key producers, suppliers and other industry experts.

Phase Three:

Based on the information found in the first two phases, ABG brainstormed numerous attributes that could potentially add value to a pork food system. A complete questionnaire was developed, including the attributes to be tested, and 35 decision makers throughout the pork value chain where interviewed. A complete list of the attributes tested can be found in Appendix III. The decision makers interviewed include genetics companies, packers, processors, branded pork companies, brokers, retailers and food service professionals. Specific results on those surveys are found in Section V of this report. In addition, significant secondary research of studies related to this subject was performed. A summary of the key learning from the secondary research can be found in Appendix II.

Phase Four:

ABG developed potential business models based on the feed back from value chain participants. These are high-level business models aimed at giving directional context, rather than answering every little detail for each model. These models where further developed to include which players where involved, what the relationship might look like, how value is being created, what the market size may look like and the challenges associated with each model. These models where then ranked based on market size, margin/hog, risk, complexity and product development challenges. The models are found in Section IV of this report.

III. Executive Summary

Approach/Methodology
ABG utilized a four-phase approach to complete this project. The first phase included the development of a complete overview of the pork industry including trends in production and processing. This phase was completed and presented in 2001. The second phase included a pre-market assessment of the pork value chain and initial concept development and testing. The third phase included the development of a comprehensive interview guide and completed interviews with 35 decision makers throughout the pork value chain. In the final phase, ABG built and ranked potential business models for producer controlled pork systems.

Results
A complete analysis of the pork industry makes it clear that there are no "home runs" or easy money to be found by pork producers interested in integrated or coordinated pork systems. This is a direct result of the largely commodity view of pork held by consumers and value chain participants.[3] This observation is consistent with both ABG's research and other studies of the pork value chain.

ABG research showed that retailers and food service companies were generally quite happy with the pork product they receive. Two food service companies suggested they would be quite interested in purchasing a non-enhanced, better tasting pork product. Some retailers are also beginning to look for alternatives like antibiotic-free or natural pork to differentiate themselves in the meat case, which may create some niche opportunities. Packers tend to continue to see pork as a pure commodity and few, if any, genetics companies have any truly differentiated hog lines.

Models
A picture of a very competitive pork market is accurate, but there may be opportunities for producers to capture incremental gains through coordinated systems. Nine models are outlined that may be of interest to different producer groups depending on their individual situation. They are included below in ranked order.

1. Sell Pork Direct to Consumers in my Community
2. Locally Grown
3. Selling to a Large Grocer/Vertical Coordination
4. Selling to a Large Grocer/Vertical Integration
5. Underserved (Small) Customer
6. Flexibility/Speed/Agility
7. Organic
8. Highest Product Consistency
9. Better Tasting Pork

[3] Mike Lemon, Premium Marketing LLC, September 2000

Ranking

ABG ranked these models using a 1-10 scale for five categories. They are:

- Market Size
- System Complexity
- Margin/Hog
- Risk
- Product Development Challenges

Each category was weighted equally. This assessment was primarily qualitative and the models were compared in relation to one another.

Recommendations and Next Steps

Based on the research and models created, ABG suggests that Pork Producer Associations can take a number of important steps when working with producer groups interested in being part of a coordinated pork system. One of the most important steps suggested is to challenge producer groups to think through the hard questions associated with a coordinated pork system. Associations can also take steps to be familiar with other producer groups that exist and probe for opportunities for pork producer in their state. Finally, Associations can take important coordination and evaluation steps as producer groups analyze different models.

Alternatives

Coordinated food systems are output systems, focused on what output or attribute the pork product will exhibit. Input systems are focused on the inputs necessary to raise the hogs. These input systems, focused on lowering input cost through collective bargaining, for example, may be a good alternative to output systems. A detailed analysis of input systems is beyond the scope of this project, but should be considered as another method of making hog farmers more competitive.

IV. Models

The following nine models represent examples of potential approaches to creating coordinated food systems or direct integration into the pork industry. The models are listed in order, with the highest ranked model listed first. The reasons behind the ranking of these models are found in Section V.

Different models may be appealing to different farmers or farmer groups. Each model has its strengths and weaknesses. ABG recommends that a feasibility study and appropriate due diligence be performed before investing significant equity into any model.

The models are:

1. Sell Pork Direct to Consumer in my Community Model
2. Locally Grown Model
3. Selling to a Large Grocer/Vertical Coordination Model
4. Selling to a Large Grocer/Vertical Integration Model
5. Underserved (Small) Customer Model
6. Flexibility/Speed/Agility Model
7. Organic Model
8. Highest Product Consistency Model
9. Better Tasting Pork Model

Model 1: Sell Pork Direct to Consumers in my Community

Overview

An individual farmer or a small farmer group would sell pork directly to local consumers, retailers, or restaurants a half or whole hog at a time. The farmer, or farmer group, would work with a local butcher to slaughter and process the pork. This pork could then be delivered (for a price) or could be picked up by the customer.

Logic

This model was created based on the logic that removing the retailer, who captures the most total dollars in the value chain, would allow the farmer to capture additional value. This model also delivers what consumers find most important in their meat product: food safety, meat quality and taste.

Product and Partners

Farmers utilizing this model would sell frozen pork processed to meet the customer's desire, allowing for a high level of processing or packaging customization. The participants in this value chain include the farmer, the local butcher, and the customer. A contractual relationship with the butcher, with differing prices based on the level of processing, would likely be the most desirable relationship. The farmer would retain ownership of the meat and would have a buy/sell relationship with the customer. The ultimate driver of the model is the customer, but the farmer coordinates the business. Similarly, a state association like the Pork Producers Association could coordinate such a system on a larger scale. The driver of a system is normally the person or entity that captures the most value, is key to the success of the initiative and who can derail the entire project by not participating. The coordinator of the initiative organizes the different players and moves the initiative forward.

Value

Taking on the risk and receiving the margins normally captured by the retailer creates value in this model. Either the customer (pick up) or the farmer (delivery) can capture the value associated with the logistics of getting the product to the customer. The value proposition to the customer could be multifaceted. It could include:

- Food safety- butchered and processed by a respected locker in the community, not a huge packing plant; raised by someone you know and trust
- Local- keeping the money in the local community, support your local farmers
- Quality/Taste/Freshness- may be difficult to prove, but a great marketing approach
- Customized service- pork processed the way you want and packaged in a manner that suits your family
- Health- a non pumped (sodium free) pork product

Market Assessment

The obvious market segments are local residents, local retailers and local restaurants. Local restaurants and retailers may be problematic because they don't use the whole hog. The target market for this model would be residents within a reasonable geographic distance that own freezers and have families large enough to demand a half or whole hog at a time.

The market size clearly depends on the size and demographics of the local community or region. Other influencers will include the local and national economy, customer loyalty to their current retailer and demand for pork in the community. Competition includes the local retailers, butcher shops and home delivery companies like Schwan's.

Core Competency Requirement

The primary core competencies required to manage this model are sales and marketing skills. Logistical and coordination capabilities will be important as well.

Opportunities and Challenges

This model has the advantage of being relatively low risk, requiring little capital to get started, being easy to implement and potentially producing high gross margins. This makes this model very appealing, but there are a number of challenges as well. The most significant challenge is that this will be a relatively low volume opportunity with limited scalability. There simply are not that many families that have the desire, need or capacity for so much pork at one time. This obviously equates to no scale efficiencies within the system and a higher cost to find customers.

Other challenges include:

- Difficulties getting rid of byproducts
- High risk associated with any new business
- May distract from the primary business of raising hogs
- Logistical challenge
- Capacity of local locker or butcher shop may be limited
- Requires strong marketing and sales capabilities
- Local butcher shops may see you as a competitor rather than a partner

Considerations

- This model can succeed on a small scale, but will require some innovative and creative thinking to make it profitable. For example, farmers choosing this model may have to use marketing and sales promotions like targeted direct mailings to people who own a freezer, a co-marketing campaign with a local retailer who sells freezers, or the creation of a pork sales fundraiser for local FFA chapters.
- Producers will also have to give significant consideration to minimizing logistical challenges. One method may be to create relationships with different butchers in different communities, allowing the producer to deliver hogs to the butcher closest to the customer.
- There may be value in incorporating this business separately from the farm to protect other assets in case of liability.

Model 2: Locally Grown Branded Pork

Overview

A farmer group sells pork to local retailers and restaurants under a "locally raised" type brand, working with a regional slaughter/processor on a toll basis.

Logic

ABG research showed that 2/3 of all retailers were interested in a locally grown pork product and that there is some limited interest on the part of food service companies. Smaller, rural grocers seemed most interested in a locally grown pork product as a way to differentiate themselves.

Product and Partners

A farmer group would sell a locally raised, fresh and processed product to retailers and restaurants. The participants in this value chain include a farmer group, a local or regional packer/processor willing to do toll packing, and the retail and restaurant customers. Including a common genetics company is optional to increase the consistency of the pork product. A toll-packing contract and buy/sell relationships with customers is the most desirable relationship. There may be some opportunities for contract relationships with customers as well. The system driver is the retail or restaurant customer and the farmer group coordinates the system.

Value

Value to the end consumer is support of their local community and a sense of freshness and perceived quality associated with a "locally grown" product. Value is created for restaurants and retailers through customer loyalty to a locally grown product, and they may be able to increase their margins slightly. The producer group, through a slight premium on the product, captures some of that value.

Market Assessment

The likely initial target customer would be retail grocers and restaurants in rural communities looking for ways to differentiate themselves. This may be particularly interesting for a retail grocer competing in a rural community with a Wal-Mart.

The market potential for this model would likely start small and would have limited scalability. If the model works, however, it could be duplicated in other communities. Identifying and visiting with retailers and restaurants within a logical geographic radius, along with financial breakeven analysis would be important in choosing an initial pork volume and price.

Competition in this model would be strong, but the "locally grown" slogan would represent a reasonable differentiator. The challenges and costs associated with segregated packing and traceability would likely keep many large packers from duplicating this model. The local and national economy, along with price for other meats and the price of other pork compared to "locally grown" pork are the market drivers.

Core Competency Requirement

The primary core competencies required to manage this model are sales and marketing skills. In addition, the ability to negotiate equitable deals and flexibility will be required competencies.

Opportunities and Challenges

Research shows that numerous retailers were interested in a "locally grown" pork product as a way to differentiate from competitors. The two largest, fundamental challenges will be getting customers to pay a premium for the product and selling the whole hog at a premium with the "locally raised" brand.

Other Challenges Include:

- May distract from primary business of raising hogs
- Few scale efficiencies
- Demand variability
- Logistics challenges
- Many small restaurants and grocers buy pork through distributors who also provide them with other meat and may provide an incentive for buying all the meat from one location
- Relational industry - difficult to get customers to change suppliers
- High risk associated with any new business
- There may not be a packer/processor in the area willing to work on a toll basis
- Higher costs associated with segregated packing/processing
- A toll packing arrangement with a single company can lead to higher and higher prices or a lack of cooperation (hold-up)
- Lack of flexibility to cut or process meat according to customer requirements
- These last four challenges may require ownership of the packing/processing asset (for more detail on the advantages and challenges associated with ownership of the packing/processing assets, see Appendix IV)

Considerations

- Marketing could help increase end consumers' willingness to pay the higher price for locally grown product, easing the concern retailers and restaurants have with paying more for the product.
- A farmer group could also choose to offer just fresh meat to the restaurant and sell meat to processors as well.
- Research shows that up to 46% of consumers would be willing to pay a 10% premium for "locally grown" produce and meats.[4]
- There may be liability associated with food safety problems.

[4] "Attracting Consumers With Locally Grown Products," University of Nebraska-Lincoln, October 2001

Model 3: Selling to a Large Grocer/Vertical Coordination

Overview

A very large farmer group recognizes the consolidation occurring at the retail and packer level and decides to create a vertically coordinated system, to assure the producer of market access. In this model, a large producer group works with a packer/processor to entice a contractual relationship with a large retail grocer that appears to be one of the winners of the consolidation war. Contractual agreements would be in place between all players in the coordinated system. This would likely mean putting an approved system in place aimed at better meeting the customer's needs.

Logic

ABG research showed that retail and food service customers are happy with the current product they receive. This model mirrors the approach of the current channel. Strategically, this model is intended to be large to take advantage of economies of scale and meet the needs of a very large customer.

Product and Partners

A large farmer group would create a coordinated system to sell fresh and processed pork product to a major retail grocer. The participants in the value chain would likely include a genetics company for product consistency, the farmer group, a packer/processor and the customer. A contractual relationship with the genetics firm and the packer/processor would be an attractive relationship. Similarly, a contractual relationship would exist between the packer/processor and the retail grocer. The system driver in this model is the retail customer, but the farmer group could coordinate the initiative.

Value

The value to the retail grocer is a consistent supply of high quality pork product. The value to the packer/processor is a guaranteed market for their meat. There is no new value created for the producer group. The primary value for the producer group would be shackle space for the hogs. This is a defensive model aimed at protecting market access.

The value proposition to the retailer is a vertical production system willing to produce pork the way they want it. The value proposition for the packer/processor is a guaranteed supply of quality hogs and an assured market for the pork. There may be cost savings that both the retailer and packer/processor could realize as part of this system as well.

Market Assessment

The target markets for this model would be a large retailer likely to survive and thrive in the quickly consolidating industry. The market potential for this model would be very large and may be scalable. Competition in this model would be fierce, but the willingness to create the system to

meet the retailer's specifications may differentiate the system enough to justify a contractual relationship.

Core Competency Requirement

The primary core competencies required to manage this model are operational excellence and administrative savvy, meaning the ability to coordinate the efforts of numerous different stakeholders. Strong negotiating and selling skills would also be required.

Opportunities and Challenges

The advantage of this model is assured market and end market access, meaning the ability to stay in business. Another advantage may be the reduction in the transaction costs if a contractual agreement could be obtained. Brokers, pork buyers and pork sellers could all be eliminated from the system, decreasing cost. The primary challenge with this model is that neither large retailers nor packers perceive any problem with the current system. The potential cost savings of a coordinated system would have to be sold to each group to convince them to participate. Without a contractual arrangement, this model may be unfeasible.

Other Challenges Include:

- May distract from primary business of raising hogs
- Difficult to find and coordinate such a large, sophisticated system
- May see a decrease on the margin captured per hog for the system compared to the open market
- Likely require a genetics and production change for producer
    - Operation protocols to assure consistency required by the industry
- Relational industry-difficult to get customers to change suppliers
- High risk associated with any new business

Considerations

- Creating such a producer group may provide an opportunity to create input systems that could collectively negotiate better prices for breeding stock, feed, antibiotics, vet services and other input supplies and services.
- There may be additional costs that can be driven out of such a closely linked supply chain like distribution and warehousing costs.
- This model may also work with a large food service company as an alternative to a large retailer.
- There may be liability associated with food safety problems.

Model 4: Selling to a Large Retailer/Vertical Integration

Overview

This model is very similar to Model 3, but the focus is on integration of a system, requiring ownership of the packing and processing assets. In this model, a large producer group integrates into the market and works to entice a contractual relationship with a large retail grocer that appears to be one of the winners of the consolidation war. This would make sense if a market assessment showed a willingness to participate on the part of a large retailer, but packer/processors were unwilling to participate.

Logic

ABG research shows that retail and food service customers are happy with the current product they receive. This model mirrors the approach of the current channel. Strategically, this model is intended to be large to take advantage of economies of scale and meet the needs of a very large customer.

Product and Partners

A large farmer group would sell fresh and processed pork product to a major retail grocer. The participants in the value chain would likely include a genetics company for product consistency, the farmer group, owned packing and processing facilities and the customer. A contractual relationship with the genetics firm would be an attractive alternative. Ideally, a contractual relationship with the retail grocer would exist as well, minimizing risk for the producer group. There may be an opportunity for cost savings that both the retailer and farmer group could realize as part of this system as well. The system driver in this model is the retail customer, but the farmer group could coordinate the initiative.

Value

The value to the customer is a consistent supply of high quality pork product. There is no new value created for the producer group. The primary value for the producer group would be an assured market for the pork and shackle space for the hogs. This is a defensive model aimed at protecting access to the market. The value proposition to the customer is a vertical production system willing to produce pork exactly the way the retail grocer wants it.

Market Assessment

The target markets for this model would be a large retailer likely to survive and thrive in the quickly consolidating industry. The market potential for this model would be very large and may be scalable. Competition in this model would be fierce, but the willingness to create a system to meet the retailer's specifications may differentiate the system enough to justify a contractual relationship.

Core Competency Requirement

The primary core competency required to manage this model is operational excellence, which includes efficient plan management, processing efficiencies and coordinated production. Strong negotiating and selling skills would also be required.

Opportunities and Challenges

The primary advantage of this model is assured market and end market access, meaning the ability to stay in business. Another advantage may be the reduction in the transaction costs if a contractual agreement could be obtained. Brokers, pork buyers and pork sellers could all be eliminated from the system, decreasing cost. The primary challenge with this model is that most large retail grocers are quite happy with the pork product they currently get. This means the producer group may be seen as just another supplier and would be unable to attain a contractual relationship that would reduce risk. In addition, the retailer is likely going to require proof of a system's ability to produce the promised product before signing any contract, increasing the risk to the producer group.

Other Challenges Include:

- May distract from primary business of raising hogs
- Difficult to find and coordinate such a large, sophisticated system
- May see a decrease on the margin captured per hog for the system compared to the open market
- Likely require a genetics and production change for producer
    - Operation protocols may be put in place to assure consistency required by the industry
- Relational industry - difficult to get customers to change suppliers
- High asset requirement associated with buying or building packing and processing facilities
- High risk associated with any new business
- Asset specificity of packing/processing facilities (only one use for the facility/equipment)

Considerations

- This model could be successful at assuring shackle space for producers even if a large retail grocer is unwilling to sign a contractual agreement. In that case, this model would not assure a final market for the meat product and the risk to the producer group would increase.
- Creating such a producer group may provide an opportunity to create input systems that could collectively negotiate better prices for breeding stock, feed, antibiotics, vet services and other input supplies and services.
- There may be additional costs that can be driven out of such a closely linked supply chain like distribution and warehousing costs.
- This model may also work with a large food service company as an alternative to a large retailer.
- There may be liability associated with food safety problems.

Model 5: Underserved (Small) Customer

Overview

A farmer group integrates into the pork industry to serve smaller, underserved customers. The farmer group utilizes a toll packing arrangement (if possible) to provide fresh pork to small processors, small retailers and others who are receiving lower quality of product from large packers.

Logic

Some primary and secondary research indicated that small processors and retailers are underserved. They are having difficulty finding a source that will reliably deliver the type of product they need. They are also having difficulty finding a high level of consistent, quality pork. These findings were not consistent across all participants surveyed.

Product and Partners

A farmer group would sell fresh pork product and provide the highest service to small processors, retailer, food service and export markets. The participants in the value chain include a genetics company for product consistency, the farmer group, a toll packer and the customers. A toll packing relationship or contract with a packer would be preferable, and a buy/sell relationship with the customer and genetics firm is most likely. The ultimate system driver of the initiative is the small customer, but the farmer group could coordinate the initiative.

Value

The value to the small customer is access to consistent, quality pork that they may not have access to from large companies with more important clients. The producer group captures value by charging a slight premium for fresh pork.

Market Assessment

The target markets for this model would be small retail chains and small processors. The market potential for this model would be relatively small and not easily scalable. Competition in this model would be fierce, with all packers, large and small, competing with you. Every pound of pork sold would have to be won over from some other vendor. The local and national economy, along with competition would be the primary market drivers in this model.

Core Competency Requirement

The primary core competencies required to manage this model are sales and marketing skills. In addition, the ability to negotiate equitable deals and high customer service attitude will be important to success.

Opportunities and Challenges

The advantage of this model is serving an underserved segment that sometimes has trouble getting access to high quality product. The primary challenge with this model is finding customers willing to pay a premium for access to consistent, quality product.

Other Challenges Include:

- May distract from primary business of raising hogs
- Many small retailers receive pork through large distributors/wholesalers, meaning they may be insulated from receiving poor consistency in the quality of their pork
- Relational industry - difficult to get customers to change suppliers
- High risk associated with any new business
- Higher costs associated with segregated packing/processing
- A toll packing arrangement with a single company can lead to higher and higher prices or a lack of cooperation (hold-up)
- Lack of flexibility to cut or process meat according to customer requirements
- These last four challenges may require ownership of the packing/processing asset (for more detail on the advantages and challenges associated with ownership of the packing/processing assets, see Appendix IV)

Considerations

- Without achieving a price premium from the underserved market, this model would be little more than vertical coordination and no new value would be created.
- There may be liability associated with food safety problems.

Model 6: Flexibility/Speed/Agility

Overview

A farmer group purchases packing and processing facilities and then identifies niche market opportunities and moves quickly to take advantage of them, always staying ahead of the larger, slower moving competitors.

Logic

ABG primary research included two mid-sized retailers that where working to differentiate their pork product by selling a premium product and an antibiotic-free product. These retailers, along with specialty retailers, the growth in organic pork and ethnic markets all point to an opportunity for a model oriented around identifying and serving niche markets and quickly exiting and finding alternative markets if larger, lower cost packer/processors enter the market.

Product and Partners

A farmer group would sell niche products and provide a high level of customer service to retail grocers, food service companies and the export market. The participants in this value chain include a farmer group, farmer owned packing and processing facilities, and the customers. Including a common genetics company is optional to increase the consistency of the pork product. Ownership of the packing and processing facilities provides the needed flexibility for this operation, while a traditional buy/sell relationship would exist with customers. Contract opportunities could exist with buyers in specific instances for defined terms. The system driver is the niche customer and the farmer group coordinates the system.

Value

Value is created for the customers because they are able to differentiate their product offering to the end customer. The farmer group captures value by charging a higher price for these differentiated niche products. The primary value proposition to the customer is the ability to create a customized product to meet their needs quickly and efficiently.

Market Assessment

A likely initial target customer would be ethnic butcher shops and retailers, but could include anyone trying to differentiate their product offering.

Finding niche customers or customers wanting customized product and willing to pay a premium for it means that the initial market size is small. The producer group would want to run the packing and processing facilities as close to capacity as possible, meaning they would have to sell commodity pork while they build the customized/niche business. Over time, more and more capacity would be dedicated to niche and customized products. A financial breakeven analysis would be important in choosing an appropriate initial pork volume.

Competition in this model would be strong, especially when selling undifferentiated, fresh pork. It is also likely that as profitable niches grow, competition will enter the market and drive down the margins. This model requires a constant scan for new niches and the speed to take advantage of them before others can. The local and national economies, along with competition within different niches are the primary market drivers.

Core Competency Requirement

The primary core competencies management should have in this model are opportunity identification and market assessment capabilities. Flexibility, problem solving and very good sales skills will also be required.

Opportunities and Challenges

Higher margins and less competition should be the advantages of competing in niche and customized markets. A significant challenge for this model is that large competitors with lower cost production will enter these markets, as they grow profitable, driving down margins and requiring constant change. An equally important challenge is that some niches may prove to be fads and disappear over time.

Other challenges include:

- May distract from primary business of raising hogs
- Logistics challenge
- Must choose the right niches at the right time
- Capital requirements of ownership of slaughter/processing facilities
- High risk associated with any new business
- Asset specificity of packing/processing facilities (only one use for the facility/equipment)
- Relational industry- hard to win over new customers
- High cost of finding and attaining new customers
- Inefficiencies associated with customized packing and processing
- Demand variability

Considerations

- It would be particularly important to perform a thorough scan of potential customers to identify their level of interest and willingness to pay a premium before investing significant capital in this model.
- There may be some value in utilizing a branding strategy, where appropriate, to decrease the willingness for consumers to switch from the farmer group's product to another product, helping protect a price premium.
- There may be liability associated with food safety problems.

Model 7: Organic Pork

Overview

A farmer group produces an organic pork product, utilizing a toll packing/processing relationship, branding the pork and selling it to export, restaurant and retail markets.

Logic

Secondary research on organic meats show that $475 million of organic meat will be sold in 2002, with growth rates estimated between 30% and 175% annually for the next five years.[5] It is likely that poultry makes up a large portion of these sales, but the growth in this area is compelling enough to consider an organic model. Primary research showed very limited demand for organic pork in the tri-state area, but did not analyze demand for this product on the East Coast.

Product and Partners

A farmer group would sell an organically raised fresh and processed product to the export market, high-end restaurants, health and natural foods stores and mass-market grocers. The participants in this value chain include a farmer group, farmer owned packing and processing facility, and the customers. Including a common genetics company is optional to increase the consistency of the pork product. The packing and processing steps would likely have to be owned to meet the strict organic standards. The system driver is the customer and the farmer group coordinates the system.

Value

Value to the end consumer is likely the perceived food safety advantage of organic pork. Value is created for export customer, restaurants and retailers through the premium they charge for organic product. The producer group would also capture value by charging a premium for the product as a result of meeting the extensive organic production standards.

Market Assessment

The likely initial target customer would be export customers and high-end restaurants (through food service) on the east coast. To achieve volume, working with natural and organic distributors to get the product into the hands of natural and organic food stores would be a must. It is estimated that 2% of organic food is sold through export, 2% is sold through high-end restaurants, 55% is sold through health and natural food stores and 42% is sold through mass-market retailers.[6]

The market potential for this model would be very small but has the potential to grow.
Direct competition in this model would be limited, but the substitutability of pork not labeled organic, meat alternatives and organic chicken and beef is very high. The local and national economy, along with price for other meats and the price of other pork compared to "organic" pork are the market drivers.

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[5] 2001 Organic Trade Association's "Manufacturers' Survey"
[6] 2001 Organic Trade Association's "Manufacturers' Survey"

Core Competency Requirement

The primary core competencies required to manage this model are the sales and marketing skills required to sell a premium product. In addition, all farmers joining this type of system would have to be open to change their production approach.

Opportunities and Challenges

High margins and somewhat limited competition selling organic pork makes this model attractive. In addition, the rules associated with organic production will slow the entrance of additional competitors, potentially protecting the high margins for some period of time. The two largest, fundamental challenges will be finding customers willing to pay a premium for organic pork and selling the whole hog.

Other challenges include:

- May distract from primary business of raising hogs
- Capital requirements of building a brand
- Some retailers want to do their own branding
- Requires changes in production and facilities for most producers
- Price premium may not offset production inefficiencies
- Some competition already in place and numerous substitutes exist
- Relational industry - difficult to get customers to change suppliers
- More competition will come as demand increases
- Logistics challenge associated with limited demand
- Must find alternative market(s) for lower value cuts
- Capital requirements of ownership of slaughter/processing facilities
- High risk associated with any new business
- Asset specificity of packing/processing facilities (only one use for the facility/equipment)

Considerations

- Marketing could help increase end consumers 'willingness to pay the higher price for organically grown products.
- Producers interested in pursuing an organic model should consider alignment with an existing organic system as an alternative to building their own system.
- An assessment of product supply and demand in the targeted geography would be important before moving forward with the organic model.
- There may be liability associated with food safety problems.

Model 8: Highest Product Consistency

Overview

A farmer group works with a genetics company and food retailer to create a system with the highest level of pork product consistency. The product would have to have high meat quality standards (color, pH, water loss, etc.) and very little variation, requiring strict production protocols. For example, the genetics supply, feed ration, health protocols, etc. would all be in place to standardize the end pork product. The result should be more efficient slaughter, processing and cooking results.

Logic

Primary and secondary data show that product consistency is very important to nearly all processors, retail grocers and food service companies. Because of its importance and the potential for efficiency gains throughout the value chain with a highly consistent product, a model based on consistency seems logical.

Product and Partners

A farmer group would sell a highly consistent fresh pork product to processors, retailer, food service and export markets. The participants in the value chain include a genetics company, the farmer group a toll packer and the customers. A joint venture or related business relationship with a genetics company would likely be a necessity to increase product consistency. A toll packing relationship or contract with a packer would be preferable, and a buy/sell relationship with the customer is most likely, although a contractual relationship would be preferred. The ultimate driver of this initiative is the customer, but the farmer or a genetics company could coordinate the initiative.

Value

Value is created for customers through efficiencies associated with consistency. This may enable the capture of a slight premium for the pork product by the farmer group. The efficiency gains at the packing level may not be easily recognizable and so a premium from the packer seems unlikely. In addition, packer's view of pork as a commodity likely requires ownership of the meat beyond slaughter to capture the added value of consistency. The value proposition to processors is that the consistent primal cut size, conformation, and water loss equates to more efficient operations. The value proposition to the retail customer and end consumer is consistent cooking results. Food service and export markets may also be interested in a more consistent product.

Market Assessment

The likely initial target customer would be small processors who don't own packing facilities and who are not currently happy with the consistency of the product they are receiving from larger packers. Another important potential market may be retailers trying to differentiate their meat case with a highly consistent product that will cook the same each time. Initially, the industry will question the ability for a small producer group to provide more consistent pork than Smithfield for

example. It would be necessary to quantify to customers how much more consistent their product is and what it means to the customer in dollars and cents.

The market potential for this model would likely start small, but would be scalable depending on customer acceptance and ability to add hogs to the system. Identifying and visiting with processors within a logical geographic radius, along with financial breakeven analysis would be important in choosing an initial pork volume.

Competition in this model would be fierce, with both integrators and every other packer competing with the producer group. Every pound of pork sold would have to be won over from some other vendor. The local and national economy, along with competition would be the primary market drivers in this model.

Core Competency Requirements

The primary core competency required to manage this model is operational excellence, including the development and management of strict protocols. Sales skills will also be important.

Opportunities and Challenges

Consistency is a widely verbalized, very important industry issue. Creating a recognizably more standardized product could be beneficial, making this model appealing. As expected, there are a number of challenges to the model as well. The most significant challenge is creating a system that produces a recognizably more consistent hog. This is particularly difficult because integrators like Smithfield can and do control everything from genetics through processing.

Other challenges include:

- May distract from primary business of raising hogs
- The industry already provides a very consistent product that most customers are happy with
- Packers provide cooking consistency through enhancement (12% water & sodium solution)
- Requires changes in production and genetics for producers
- Relational industry, so it is difficult to get customers to change suppliers
- High risk associated with any new business
- Higher costs associated with segregated packing/processing
- A toll packing arrangement with a single company can lead to higher and higher prices or a lack of cooperation (hold-up)
- Lack of flexibility to cut or process meat according to customer requirements
- These last four challenges may require ownership of the packing/processing asset (for more detail on the advantages and challenges associated with ownership of the packing/processing assets, see Appendix IV)

Considerations

- A brand strategy is likely unnecessary when selling to processors and to retailers who utilize their own brand.
- There may be liability associated with food safety problems.

Model 9: Better Tasting Pork

Overview

A farmer group works to create a recognizably better tasting fresh pork product. This could be created through genetically or through production practices (feeding). The farmer group would utilize a toll packing relationship and maintain ownership of the fresh pork product.

Logic

ABG research showed two of five food service companies suggested that they needed a better tasting, non-enhanced pork product. A number of retailers where also interested in a better tasting pork as well. This strong interest makes a better tasting pork model a logical inclusion.

Product and Partners

A farmer group would sell a recognizably better tasting pork product to the export and high-end restaurant markets through the food service channel or meat distributors. The participants in the value chain include a genetics company, the farmer group, a toll packer and the customers. If the better tasting pork were developed through the genetics company, a joint venture, or related business agreement, with the genetics company would likely be a necessity. A toll packing relationship or contract with a packer would be preferable, and a buy/sell relationship with the customer is most likely. The ultimate driver of the initiative is the customer, but the farmer or a genetics company could coordinate the initiative.

Value

Recognizably better tasting pork is an ongoing request of the export market and has been requested by some food service companies looking to provide a differentiated product to high-end restaurants. The producer group would capture value through a premium charged for the product. The value proposition is "better tasting" pork for people of discerning taste.

Market Assessment

The likely initial target customer would be export and food service markets because of the higher margin potential. This model may also be expanded to include high-end retailers or butcher shops with customers sophisticated enough to recognize and pay for increases flavor.

The market potential for this model would likely start small, but would be scalable depending on production capacity and consumer acceptance. Competition in this model would be very strong. Numerous firms are claiming to have a better tasting pork product, or at least a higher end pork product. In addition, many firms that differentiate pork with seasoning would compete for the same business. Showing a recognizable difference in pork quality and consumer preference would be important in gaining customer and consumer acceptance. The local and national economies, along with competition would be the primary market drivers in this model.

Core Competency Requirement

The primary core competency required to manage this model is the research capabilities to create a recognizably better tasting pork product. In addition, sales and marketing skills will be required for success.

Opportunities and Challenges

A better tasting pork product is a stated need of at least some food service customers and would likely be attractive to export markets. This means higher margins. The primary challenge associated with this model is the development of a recognizably better tasting pork product. If a genetics company can create such a pork product, they are likely to capture most of the value added as well.

Other Challenges Include:

- May distract from primary business of raising hogs
- Would likely require a genetics change for producers
- Strong competition
    - One large integrator and some smaller companies already makes this claim
- Low initial volume could result in cash flow and distribution challenges
- Enhancement and marinades are currently available alternatives to a "better tasting" pork product
- Relational industry - difficult to get customers to change suppliers
- High risk associated with any new business
- Higher costs associated with segregated packing/processing
- A toll packing arrangement with a single company can lead to higher and higher prices or a lack of cooperation (hold-up)
- Lack of flexibility to cut or process meat according to customer requirements
- These last four challenges may require ownership of the packing/processing asset (for more detail on the advantages and challenges associated with ownership of the packing/processing assets, see Appendix IV)

Considerations

- A farmer group may want to consider aligning itself with an existing system that promises better tasting pork.
- A brand strategy should be considered, but may not be most effective with export or food service customers, because they want to control their own brand.
- An alternative to creating better tasting pork genetically is creating better tasting pork through a processing method. This pork would then be processed or enhanced pork rather than fresh pork.
- There may be liability associated with food safety problems.

V. Comparison of Top Models

This table represents an effort to quantify how the models compare to one another in five important categories. These numbers are intended to be comparative and are not absolute in relation to one another. These numbers are not intended to communicate actual qualitative research.

	1-10	1-10	1-10	1-10	1-10	1-50	
	10 = Large Market	10 = Least Complexity	10 = Most Margin/Hog	10 = Lowest Risk	10 = No Development Problems	Add Up Columns	
Model	**Market Size**	**System Complexity**	**Margin/Hog**	**Risk**	**Product Development Challenges**	**Index Score**	**Rank**
Sell Pork Direct	2	9	9	8	10	38	1
Locally Grown	3	7	2	7	10	29	2
Selling to a Large Grocer/ Vertical Coordination	10	2	1	3	10	26	3
Selling to a Large Grocer/ Vertical Integration	10	1	1	1	10	23	4
Underserved (Smaller) Customers	4	4	1	3	10	22	5
Flexibility/ Speed/ Agility	3	3	2	1	10	19	6
Organic	1	3	2	2	10	18	7
Highest Product Consistency	6	3	1	1	6	17	8
Better Tasting	4	2	4	2	1	13	9

The five categories represent important business considerations ABG identified for comparing these models:

- Market size primarily focuses on the number of hogs that could be involved in such a system.
- System complexity focuses on the difficulty associated with developing and managing the system.
- Margin/hog is the expected financial margins on a per hog basis. For a more detailed look at how margins were estimated, see the margins chart later in this section.

- Risk represents both the risk of dollars invested and the chance for failure.
- Product development challenges were included to try to quantify the difficulty associated with developing a better tasting pork product and the development of the highest product consistency.

As the analysis shows, slow and steady wins this race. Because of the high margins/hog, the low level of risk, and simplicity to implement, the "Sell Direct to Consumers" model is most attractive. It is clearly a small opportunity, but it may be enough to help keep some producers in business. While the margins are lower, the "Locally Grown" model comes in second because of the lower risk and limited complexity. This model is appealing if retail grocers, restaurants and end consumers are willing to pay a premium for a locally grown pork product. The "Mass Market Access/Vertical Coordination" and "Mass Market Access/Vertical Integration" models both have merit in a market situation where access to a packer or access to the end market is in doubt. All other models have serious challenges to overcome.

The target "Underserved (Small) Customers" model could succeed if small customers are willing to pay a premium for access to consistent product. The "Flexibility/Speed/Agility" model is attractive if sufficient niches, willing to pay a premium, can be found and the capability to move quickly into new markets is developed. The "Organic" model may become more appealing if demand for organic pork grows. The "Highest Product Consistency" model is attractive if a highly regulated system could result in a highly consistent pork product that customers and consumers would pay a premium for. The "Better Tasting" pork model could be quite profitable if better tasting pork can be created and the business is scaled appropriately.

Sell Pork Direct to Consumers in my Community
This model has a very low market size rating because it is unlikely that an individual producer could sell more than a few hundred hogs a year this way. Because an individual farmer could easily implement this model and begin selling hogs immediately, this model gets a very favorable system complexity score. With the value chain shortened and the retail margins eliminated, a high margin/hog is attainable. Very little money must be invested to start this system, resulting in a favorable risk score. This system does not face any significant development challenges to begin operating.

Locally Grown
This model has a low market size rating because there is likely a limited number of restaurants and retailers willing to pay a premium for a locally grown pork product. Because a small group of producers could move forward quickly, this model gets a favorable system complexity score. Consumer research shows that many consumers are willing to pay only a slight premium for locally grown meat, keeping the margins/hog relatively low. A limited amount of money and time must be invested to start this system, resulting in a favorable risk score. This system does not face any significant development challenges to begin operating.

Selling to a Large Grocer/Vertical Coordination Model
This model, by its very name, has a large market size rating because it would be built to take advantage of scale and meet the needs of a large retailer. Because it would take a large group of

producers willing to change the way they do business, and would fundamentally change the relationship with both the packer and retailer, this model gets a very low system complexity score. There would likely be no increase in margins in this scenario and may initially reduce the margins received on a per hog basis. A significant amount of time and some money must be invested to start this system and the chance of failure is high, resulting in a low risk score. This system does not face any significant development challenges to begin operating.

Selling to a Large Grocer/Vertical Integration Model
This model, by its very name, has a large market size rating because it would be built to take advantage of scale and meet the needs of a large retailer. Because it would take a large group of producers willing to change the way they do business and would require significant fundraising, this model gets a low system complexity score. There would likely be no increase in margins in this scenario and may initially reduce the margins received on a per hog basis. A significant amount of money and time must be invested to start this system and the chance of failure is high, resulting in a low risk score. This system does not face any significant development challenges to begin operating.

Underserved (Small) Customer Model
This model has a limited market size rating because small processors and retailers consume so little total pork volume. It would take a sizable group of producers willing to change the way they do business and requires fundraising, resulting in a mid-ranged system complexity score. There would likely be some small increase in margins in this scenario, but not significant enough to improve the margin score above a one. A sizable amount of money and time must be invested to start this system and the chance of failure is high, resulting in a low risk score. This system does not face any significant development challenges to begin operating.

Flexibility/Speed/Agility Model
This model has a limited market size rating because niche customers demand so little total pork volume. It would take a sizable group of producers willing to change the way they do business and would require fundraising to make this model work, resulting in a relatively low complexity score. There would likely be noticeable increase in margins in this scenario, resulting in a score of three. A sizable amount of money and time must be invested to start this system and the chance of failure is high, resulting in a low risk score. This system does not face any significant development challenges to begin operating.

Organic Model
This model has a very small, but growing market size. A small group of producers would have to be willing to significantly change the way they produce hogs and would require fundraising, resulting in a low complexity score. There would likely be noticeable increase in margins in this scenario, resulting in a score of three. The risks associated with changing production, purchasing a packing/processing facility and marketing a product with limited demand resulting in a very low risk score. This system does not face any significant development challenges to begin operating.

Highest Product Consistency Model
This model has a mid-range market size score because it meets the fundamental needs of all pork buyers, but not all buyers are willing to pay a premium for the highest consistency product. Because it would take a large group of producers willing to change the way they raise hogs and would require the coordination of a toll packing relationship, this model gets a low system complexity score. There would likely be some small increase in margins in this scenario, but not significant enough to improve the margin score above a one. A significant amount of time and some money must be invested to start this system and the chance of failure is high, resulting in a low risk score. This system does face the development challenge of creating a system that results in noticeably more consistent pork before it can begin operating.

Better Tasting Pork Model
This model has a mid-range market size score because there is a limited number of customers and consumers willing to pay a premium for better tasting pork. Because it would take a mid sized group of producers willing to change the way they do business, requires a close relationship with a genetics company and the coordination of a toll packing relationship, this model gets a low system complexity score. There would likely be a nice increase in margins in this scenario, resulting in a score of four. A significant amount of time and some money must be invested to start this system and the chance of failure is high, resulting in a low risk score. This system does face the development challenge of creating better tasting pork through genetics, production practices or processing before it can begin operating.

Margin/Hog Table

The purpose of this table is to help the reader understand the market and cost assumptions used to determine the margin rating found at the beginning of this section. The Status Quo numbers are industry averages of dollars captured by different segments of the pork value chain. All other numbers were qualitatively created for illustrative and comparison purposes only, and are not absolute in relation to one another. These numbers are not intended to communicate actual qualitative research.

							Retail & Marketing Cost	Consumer Purchase Price
Status Quo	**$90**	**$100**	**$10**	**$22**	**$38**	**$25**	**$155**	**$340**
Sell Pork Direct	$90	$180	$90	$40	$45	$25	$50	$340
Locally Grown	$90	$109	$19	$28	$38	$30	$175	$380
Large Grocer/ Vertical Coordination	$90	$100	$8	$24	$38	$25	$157	$340
Large Grocer/ Vertical Integration	$90	$96	$6	$24	$40	$25	$155	$340
Smaller Customer	$90	$104	$14	$30	$41	$28	$155	$357
Flexibility/ Speed/ Agility	$90	$115	$25	$35	$45	$40	$190	$425
Organic	$125	$142	$17	$35	$45	$40	$180	$442
Highest Product Consistency	$95	$107	$12	$25	$42	$25	$175	$374
Better Tasting	$120	$156	$36	$28	$38	$35	$185	$442

In all cases the sale price is determined by evaluating an estimated selling price for the pork then subtracting the estimated retailing and marketing, distribution, packing, and processing costs. The margin was determined by subtracting the estimated sales price from the estimated cost of production. To find the margin ranking found on the margin analysis sheet the margin numbers found on this sheet were divided by ten and rounded to the nearest whole number. For example a

margin of $17 / 10 = 1.7 rounded to a 2. In some cases, it is assumed that consumers will be willing to pay a price premium for the pork product. Assumptions should not be mistaken for facts.

VI. Detailed Research Results

Packers

Packers see pork as a pure commodity. They are very happy with the current pork product resulting from the hogs they are receiving from farmers. There is almost no situation where they would consider paying more for pigs or situations where they would get paid more for their pork. Packers also do not believe there are any untapped market opportunities. They believe that the large packers or integrators would soon fill any profitable niche. One packer said, "Niche markets don't last long. If it is profitable, someone will catch on." While this "commodity" attitude represents insight into a very efficient and effective industry, it likely makes it difficult for some packers to think "outside the box."

Because of this "commodity" attitude, some packers may not be good choices to include in coordinated pork systems. This means a producer group may have to work directly with a retailer, food service company or export buyer to create coordinated systems, and then find a packer willing to work on a toll basis. Packers that are not operating at full capacity (usually smaller packers) are most likely to be open to toll packing opportunities.

Genetics

Like the packers, genetics suppliers largely do not believe they are delivering a truly differentiated product right now. Most are producing hogs that result in consistent, high quality pork. One did suggest that their company had a line with higher intra-muscle marbling, which may equate to better tasting pork. Others suggested that they were capable of producing pork that suffered less water loss and yielded more sellable meat. Packers spoken to for this project did not see noticeable differences between genetics suppliers. Genetics companies are interested in participating in coordinated pork systems as a method of selling more breeding stock. Some companies have initiatives like these already in place.

Retailers

Most retailers, both large and small, are quite happy with their current pork product. They mentioned that pork is better today than it was even just a few years ago. They expect quality and consistency and receive it regularly from their suppliers, making price a primary determining point for deciding which supplier to work with.

While many retailers have a commodity attitude towards pork, other retailers are working to differentiate their pork product. Some take broad approaches to differentiate themselves by going to case ready pork or continuing to cut their own in-house. Others purchase certain seasoned or precooked products to differentiate themselves. One retailer is buying non-enhanced, antibiotic free pork from a major processor and selling it at a premium. This retailer said customers are willing to pay more for that product to avoid the sodium associated with the enhanced product (sodium and water solution), or for safety reasons. This represents a small portion of their meat sales right now. Similarly, another retailer is trying to differentiate pork by providing a highly consistent, premium product that cooks the same every time. Retailers like this are looking for

opportunities to differentiate themselves and are open to hearing new ideas if they help improve margins or win over new customers.

Most retailers did not carry "organic", "antibiotic free" or "natural" pork, nor did they have enough requests for such product to warrant carrying it. One retailer said that they receive numerous supplier calls suggesting the retailer sell it, but very few customer calls requesting it. Those specialty retailers that do carry it, tend to have a small selection of products like nitrate free bacon. Even natural foods distributors do not carry much pork product, or many different cuts. It appears that organic pork is too high priced for most consumers right now.

Retailers also seem to believe there is some value in "locally grown," or "farm raised" labels. They did not believe that consumers would pay more for the product; but that they may choose such a product over other product if all else was equal. There is also a concern that the segregation of such a product throughout the value chain would be a prohibitive cost.

Food Service

Food service professionals agreed that pork is not a premier product on restaurant menus. It simply doesn't compete well with chicken or beef. They also suggested that consumers are interested in variety and differentiated products.

Two food service professionals said that they would be interested in a pork product that was truly a better tasting product, especially if the taste advantage could be supported with research. One person said, "Pork is not delivering on flavor." There was concern that packers pumping pork was diluting the flavor. Other food service professionals said they were quite happy with the quality of their current product and did not need a better tasting pork product.

There does not appear to be strong support for "organic," "antibiotic free" or "natural" pork in the food service area either. A food service professional suggested that none of their 4,000 customers was willing to pay more for organic, antibiotic-free, free range, or other differentiated pork products.

Other Decision Makers (Processors, Brokers, Distributors, etc.)

There may be opportunities to better serve small customers. Large retailers, processors and food service companies demand the highest quality and consistency of product from packers. This means the consistency and quality may be lower for smaller customers.

Individual Retail Store Flexibility

Most individual stores that are part of large retail chains do not have the flexibility of buying their own pork product. In most cases, they must source pork through the company owned distribution centers. Food safety, consistency and price negotiating power were the reasons mentioned for this approach. Some of the smaller retail chains do give the individual stores the flexibility to buy from other vendors if they wish.

Advice

Participants were given an opportunity to provide advice for a farmer group interested in being part of a coordinated pork food system. One company suggested being sure to find a market for the "whole hog" rather than just a few primal cuts. Another suggested that choosing a genetics provider whose pork did not suffer from serious water loss (purge) was very important. Other suggestions include maintaining the highest ethical standards, begin by determining what the target customer needs and maintaining product consistency.

A couple of companies that are working with producer groups to integrate into the pork value chain gave some very hard-hitting advice to farmer groups. One stated that it takes an enormous amount of work to make such a system work. He suggested that it takes a handful of people working 60 hours a week for 2-3 years just to get started. Another implied partnering and warned against building a system from scratch. It was also suggested that in the first two years, whatever the logical sales forecast is should be cut in half and whatever the expected costs are should be doubled.

Trends

Nearly everyone questioned said that pre-prepared meals and marinated, ready to cook pork products are the most prolific trend. The additional marinades and processing of the pork appears to add to the margins received for both the processor and the retailer. This effort, along with enhancing pork (injecting a sodium and water solution) is partially intended to "goof proof" pork because so few retail consumers know how to cook pork.

Some believe that prepackaged pork (seen at all Wal-Mart stores) is another important trend. Others like differentiating themselves by cutting the meat in the store and trying to communicate that they have a fresher product. They also utilize this approach to control the brand associated with the pork. This keeps consumers who are happy with the meat product loyal to the store, rather than the brand of meat they are purchasing. It was also mentioned that prepackaged pork might be advantageous in the future for small retailers who will have the flexibility to carry much more variety without holding so much inventory. There are changes in the primary distribution systems that may be required to make a prepackaged system work however.

Secondary Research

For a detailed overview of secondary research that is applicable to this project, please see Appendix II.

Attribute Summary

For a detailed list of the attributes tested and a brief summary of the results, please see Appendix IV.

VII. Recommendations and Next Steps

Recommendations

The models and the research make it clear that there are significant risks associated with coordinated or integrated pork systems. The most significant value of this study may be the context to help producer groups know when NOT to move forward with a planned system. There is significant value in keeping hog farmers from becoming another sad statistic of a producer group failure. Too often these failures cause additional financial hardship for already struggling farmers.

The Pork Producers Association is in a unique position to help facilitate the decision making process producer groups go through when trying to decide if they should be part of a coordinated or integrated system. This guidebook should be useful to help ask the necessary difficult questions as those opportunities arise.

Another way a Pork Producers Association can add value is by keeping a close eye on existing production and pork systems. Research could be done on each of the different systems, contacts could be made, and any interested parties could be introduced. ABG research indicates that more than one system would be interested in expanding into the Eastern Corn Belt. Examples of some systems and companies that may be worth tracking include American Family Farms, Niman Ranch, Sioux Nation and The Pipestone System.

In all cases, ABG recommends a thorough market assessment and feasibility study be performed, followed by the development of a comprehensive business plan. ABG has included resources in Appendix I that outline the appropriate considerations and steps to perform a market assessment and feasibility study or develop a business plan.

Next Steps

Of the models created, the "Sell Direct to End Consumers," "Locally Grown," and the two "Mass Market" models have the most potential. Some "next steps" that could be performed by the Pork Producers Association or a producer group are outlined on the following pages.

Sell Pork Direct to Consumers in my Community Model

This model likely requires a less detailed process to begin the business in comparison to models that require a large capital investment. Some initial steps include:

- Perform a market assessment
  - Identify individual farmers or farmer groups interested in participating or leading a "Sell Direct to End Consumers Model."
  - Identify target communities
    - Rural, agricultural based communities where people appreciate knowing where their pork comes from and value the direct relationship
    - Examples: Frankfort, Rochester, etc.
  - Identify the target market
    - Families with freezers that eat a lot of pork
  - Identify local processing facilities that may be able to butcher the hogs
    - Butcher/meat locker
      - Test interest
- Develop a basic business plan
  - Budgets
    - Expected sales price
    - Volume projections
    - Costs
      - Processing
      - Promotion/marketing
      - Shipping/logistics
      - Administrative
      - Insurance
  - Develop promotional campaign
    - Joint promotion with butcher
    - Joint promotion with store selling freezers
    - Newspaper adds
    - Direct mail
    - Local Associations
    - Church fundraisers
    - FFA Fundraisers

Locally Grown Model

This model requires more capital and thus requires a more detailed analysis before beginning a business. Some logical next steps include:

- Perform a complete market assessment and feasibility study
  - Identify farmer interest
    - If there is none, do not proceed
    - If there is, are they willing to fund a complete assessment?
  - Identify target market/communities
    - Mid sized to larger communities
      - Examples: Fort Wayne, Indianapolis, Muncie
  - Identify target customers
    - Restaurants, retailers, schools, etc.
  - Test interest and volume of target customers
    - Willingness to pay a premium for locally grown pork
      - How much
        - May want to consider a study to determine final consumer willingness to pay a premium for locally grown meat
  - Identify willingness of regional packer/processor to cooperate
    - Costs
    - Access (lbs. per day or week)
    - Consider carefully the desired relationship
  - Identify administrative costs and all other costs associated with the system
  - Perform financial projections to see if the venture would be profitable
    - If yes, proceed to business plan
- Develop business plan
  - Executive Summary
  - Business Profile
  - Situation Assessment and Market Environment
  - Business Model
  - Profit Model
  - Implementation Plans (financing, marketing, supply, organizational development)
  - Financial Supporting Materials
- Capital campaign/fund raising

Selling to a Large Grocer Models

These models would likely require significant resources, so a very thorough analysis should take place before investing in this model. Some logical next steps include:

- Does it appear as though the region will lose access to slaughter facilities?
    - If so proceed, if not, do not proceed with these models
- A detailed cost assessment of the financial viability of these potential models would be created
    - Identify costs associated with development
    - Identify margins farmer group can capture
    - Identify costs and benefits for each player
        - Producer group
        - Packer/processor
        - Retail grocer
            - If there is no value for the retailer, but not the packer/processor, that step may have to be owned by the system
            - If there is value for all parties, then a coordinated system may work
    - Develop the story
        - Selling points for this model would be created in presentation and hard copy form
    - Once the costs and benefits are known, the concept could be tested with each of the important players
        - Producers
        - Regional packer/processor
            - If rejected, the packing/processing facility may have to be owned by the farmer group
        - Large retail grocers
    - Based on research and financial analysis, make the "Go / No Go" decision
- Develop a detailed business plan
    - Executive Summary
    - Business Profile
    - Situation Assessment and Market Environment
    - Business Model
    - Profit Model
    - Implementation Plans (financing, marketing, supply, organizational development)
    - Financial Supporting Materials
- Capital campaign/fund raising

Appendix I: Market Assessment, Feasibility Study and Business Plan Development

Market Assessment

Traditional agriculture philosophy has been "produce first – market later." This "Field of Dreams" thinking focuses only on how to grow a product, and assumes that people will buy it once produced, often resulting in overproduction, product waste, poor market performance, and even failure.

In an increasingly consumer driven market, all successful firms are adopting customer research and assessment practices. However, the primary driver of an extensive market analysis in the start-up of a capital/investment-intensive business is to mitigate risk. A complete market analysis is critical for these reasons:

- Avoid limiting potential opportunities
- Better align business and assets for size and type of market
- Gain knowledge on how to best position product(s)
- Gain knowledge on where and with whom to best position product(s)
- Allows effective negotiation of appropriate business relationships with distribution partners and/or customers

The following dimensions are part of a thorough market evaluation:

- Potential Markets, Segments, and Geographic distribution
- Volume Consumed by Market Segments
- Competition Serving Identified Market Segments
- Define Potential Value Propositions to Target Segments
- Distribution Strategy Analysis
- Reasonable Market Share Projections
- Suggestions for Introductory Product Positioning and Marketing Strategies

Sound market analysis is a specialized skill that should be done by individuals or firms with extensive market research and analysis expertise. It is also wise to choose market analysts with experience and competence working within the proposed market segments. Poor market assessment could result in costly misdirection of the feasibility study and will ultimately be reflected in the quality of the business plan.

Feasibility Study

The feasibility study further investigates the viability of the proposed business models by building upon the information gathered during the market assessment. The feasibility study serves to answer these general questions:

- What must a business do in order to meet the needs of the identified market segments?
- How feasible is it for the proposed business to serve these markets and their needs?

- Can the proposed business accomplish these operations in a manner that sustains profitability over the long term?

The feasibility study can be the "go"/"no go" point of the project. The specific components of a complete feasibility study include, but are not limited to:

- Technical Feasibility Assessment
- Financial Feasibility Assessment with Projections
- Economic Feasibility Assessment
- Management/Organizational Feasibility Assessment

The feasibility study is an important tool in any new business venture. It will aid in decision-making moving forward, as thoughts and plans get refined and more concise. In addition, it will be an invaluable asset in determining the shape of the proposed organization to most effectively and efficiently meet the market needs. Perhaps most importantly, it serves as protection to investors, ensuring them that the proposed business model was tested thoroughly before any major investments were made. As a last point, the financial feasibility analysis can be useful and perhaps required, when presented with the business plan, in securing funds from lending institutions.

A feasibility study is not a business plan. Components of a feasibility study will be expanded upon in the business plan, but there are several key differences. These differences include:

- Feasibility studies are broader in scope and can investigate several different business model options in order to determine the most viable
- Business Plans specifically outline the chosen business model and are deeper in scope
- Business plans tend to be more detailed as they are the chosen strategy, rather than possible strategies
- Business plans are generally required, for securing financing

Business Plan

The business plan is a continuation of the analysis conducted in the feasibility study, but with much more depth and focus concerning the business model chosen by the board. Not only will the business plan be a document containing all the details of the future business structure and strategy, but lenders will also require it as part of the loan request process. This document communicates the essence of the business, so it is extremely important that the business plan is realistic and based on valid assumptions.

Many businesses feel that the business plan is just a tool designed to help secure financing. However, a thorough and detailed business plan can serve as a "road map" for beginning operations. It can be an extremely useful tool moving forward as it outlines the strategies the new venture will follow.

A complete business plan might look like the following:

I. Executive Summary

II. Business Profile
- Organization Mission/Vision
- Organization History
- Business Goals

III. Situation Assessment and Market Environment
- Price Volatility
- Process Issues
- Industry Consolidation
- Increased Desire to Integrate into the Food Supply Chain
- Desire to Better Manage Risks
- Implications of Current Situation

IV. Business Model
- Legal Organization
- Management and Ownership of Organization
    - Positions and Roles
    - Choice of Personnel
- Description of Product/Service Offering
- Description of Operational Processes
- Business Scope
    - Geographic
    - Number of Suppliers
    - Target Suppliers
    - Capacity
    - Target Markets (purchasers)

V. Profit Model
- Supplier Returns and Benefits
- Business Venture Returns and Benefits
- Other Investor Returns and Benefits
- Investment Needs
- Investor Types

VI. Implementation Plans (financing, marketing, supply, organizational development)
- Short Term Strategies
- Intermediate Term Strategies
- Long Term Strategies
- Contingency Plans

VII. Financial Supporting Materials
- Funds Required and Their Sources
- Feasibility Study - Break-Even Analysis
- Balance Sheets for 3-year Projections
- Risk Analysis/Sensitivity Analysis (variable factors to be determined)

The quality and detail of the business plan is usually an indication of the future success of an organization. Therefore, the amount of time, money, and effort dedicated to this business plan construction phase should be carefully considered.

Appendix II: Secondary Research-Key Learnings

Consumer Preferences

Two different consumer preference research studies provide insight into consumer attitudes towards meat. While consumer attitudes was not the focus of this study, the results of these studies are useful when considering a coordinated pork food system. Swanson's *Consumer Meat Preferences in Chicago* study shows that consumers believe visible traits, no hormones, taste, quality grades and no antibiotics are the most important attributes (in ranked order) when making a meat purchase.[7] Another study showed that food safety was most important to consumers, followed by quality of meat.[8] ABG's primary research matches these conclusions. Nearly all retailers stated that consumers "buy with their eyes."

Pork as a Commodity

There is evidence from other research that pork is seen primarily as a commodity and that customers are happy with their current product. "The problem is the consumer, retailer and meat buyer all view Pork as a generic product differentiated mostly by size of package and trim."[9] "By-in-large meat case SKUs are managed as commodities. Communication with suppliers is arm's length, and relationships are completely transactional." "... the chain is generally happy with the value package (price and quality) being offered."[10]

Risk

Risk is inherent in any new business venture. That rule holds very true for pork producers trying to be part of a coordinated pork food system. "Only 5 percent to 10 percent of the value-added groups make it to the point of selling a physical product. Of those, Buhr warns, success rates will be the same as any small business just starting out, which means the mortality rate can be high."[11]

Trust

The lack of trust between the different players in the pork value chain and the "transactional" type relationship limits the development of customer-oriented chains. "Major factor limiting the development of customer oriented chains within the sector is the lack of trust among people at adjacent stages. Adversarial rather than cooperative relationships predominate."[12]

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[7] Swanson, B. E. "Consumer Meat Preferences in Chicago" North Central Value-Added Conference, Kansas City, MO, May 17, 2001

[8] "Attracting Consumers With Locally Grown Products, University of Nebraska-Lincoln, October 2001

[9] Mike Lemon, Premium Marketing LLC, September 2000

[10] Goldsmith, P.; Salvador, A.; Knipe, D.; Kendall, E.; "Structural change or logical Incramentalism? Turbulence in the Global meat System" Annual Meeting of the American Agricultural Economics Association, Long Beach, CA, July, 2002

[11] Kelley, T. "Value-Added Ventures Under a Microscope" Pork, January 2001

[12] Schrader, L. "Coordination In The U.S. Hog/Pork Industry" Purdue University, October 1998

Brand

Numerous brand names exist in the meat case, but creating a new one can be a challenge. Rabobank International's "Industry Note, Food and Agribusiness," listed meat as the type of perishable commodity that is purchased primarily on price, not based on brand name.[13] Dan Murphy, Editor of Meat Marketing & Technology wrote, "Building a brand is always risky. Starting one from scratch is even dicier."[14]

Opportunity Identification

While many of our interviewees suggested that they did not think their customers would pay more for a locally grown pork product, the *Attracting Consumers With Locally Grown Products* study shows that 37% of consumers are willing to pay 10% above market price for locally grown meat and 9% are willing to pay 25% or more above market price.[15]

There may be niche opportunities for processors. "Consolidation in both processing and in retail and food service inevitably means a focus on high-volume products, and thus fewer choices for consumers. That reality… leaves specialty processors in an enviable position to compete."[16]

There may be an opportunity within a coordinated system for producers to provide smaller companies with access to a consistent, quality product. "Smaller buyers grumbled not about quality or even so much about price, but about access to the product."[17]

[13] "Industry Note, Food and Agribusiness, Rabobank International, August 2001
[14] Dan Murphy, Editor, Meat Marketing & Technology, October 2002
[15] "Attracting Consumers With Locally Grown Products, University of Nebraska-Lincoln, October 2001
[16] Meat Marketing & Technology, October 2002
[17] Goldsmith, P.; Salvador, A.; Knipe, D.; Kendall, E.; "Structural change or logical Incramentalism? Turbulence in the Global meat System" Annual Meeting of the American Agricultural Economics Association, Long Beach, CA, July, 2002

Appendix III: Attribute Summary:

The following is a summary of the different attributes and services tested with different decision makers throughout the value chain, along with a summary of the comments they made.

Product	Comments
Lean pork	Pork is lean enough
Better tasting pork	**Interest at food service level for a non enhanced, better tasting pork**
Locally raised pork	**Interest, but don't think customers will pay more $ for it**
Family farm pork	Same as local
Purebred pork (Berkshire, etc.)	No interest (except as it pertains to a better tasting pork)
Specific/Specialty cuts	Happy with current vendor's service
Case ready pork	There are large vendors already providing it for those who want it
Ethnic meats	No obvious unmet need
Export meats	Numerous large and small vendors competing for this business
Fresh pork (shelf life)	Retailers are always interested in longer shelf life for pork, but don't have a serious problem with spoilage now
Less shrink	Important, but not seen as a significant problem now
Use of non-high value products or byproducts	Efficiently used currently
Consistent Product/Throughput	
Consistent breeding/management system	Important to some customers, but not enough to demand a premium
Consistent primal cuts or specific cuts	Effectively done by current vendors
Consistent color and firmness (not watery)	Expected and delivered
Consistent grade	Expected and delivered
Higher yielding hogs	Industry is currently doing very well, can't get much higher without negative consequences
Docile breed	No recognizable value

Risk Management/Food Safety	
Antibiotic free	**Some limited interest**
GMO free	No interest
Organic/natural	**Some limited interest**
System traceability	Happy with current traceability to the packer
Efficiency Gains Possible Across Aligned System	
Timing	Happy with current delivery timing
Location (alternative distribution mechanism)	Happy with current distribution approach
Forecasting (CPFR)	Happy with current forecasting approach
Vendor Managed Inventory (VMI)	Some processed pork firms beginning to perform VMI, but not widely used or perceived as needed
Cross docking	Used currently by larger players
Manage seasonal production needs	Happy with current approach
Change the Rules of Engagement	
Change pricing model (contract)	Interested only if it is the lowest price guaranteed
Brand extension (local)	Very little interest (see locally raised)

Appendix IV: Opportunities and Challenges Associated with Asset Ownership

There are a few advantages and a number of challenges associated with the ownership of packing & processing facilities. The primary advantage of ownership is the flexibility it gives to meet customer's needs. Specific cuts can be done differently and product can be processed to differentiate the pork product. This appears to be more important now than in the past because of the value that is being added at the processing level in the form of pre-cooked and seasoned products. Another advantage for a producer group is the guaranteed shackle space for their pigs, which has become a more important issue in certain geographic areas.

One of the significant challenges to the ownership of such assets comes when the purchase of an existing facility is necessary. In most cases the seller knows the value of the continued operations of the facility better than the buyer does. This means the seller will reject an offer below the value of the facility and only accept a price that exceeds the value of the continued operation of the facility.

Some Other Challenges Include:

- Low margin industry
- High risk (all new ventures are high risk)
- Relational industry (hard to win over customers from existing vendors)
- Lack of expertise (requires giving up control to experts)
- Strong competition
- High asset specificity (only one use for the facility/equipment)
- High capital requirement
- Cash flow challenges

There are producers, manufacturers, and developers who believe small packing/processing plants can be as profitable as large-scale facilities. ABG recommends additional research before making any final decision on the ownership of the packing/processing asset.

Appendix V. Pork Coordinated Pork Food Systems Decision Tree

This simple decision tree may be useful as producer groups consider becoming part of a coordinated pork food system. It is intended to challenge the participant to think about how value is created first and then think through the system beginning with the end consumer of the product. Once answers to these questions have been answered, a market assessment, a feasibility study and a business plan can be developed.

1. How will I/we create value?
    i. Risk Management
        1. Antibiotic free (for example)
    ii. Product Differentiation
        1. Better taste (for example)
        2. Brand differentiated
    iii. Efficiency Gains
        1. Consistent inputs that increases production efficiency
        2. Consistent outputs that increase packing/processing efficiency
        3. Length of agreement (reducing transaction cost)
        4. Eliminating participants in the value chain
    iv. Changing the Rules of Engagement
        1. Different pricing strategy
2. Who is the end target consumer?
3. Do they buy branded or unbranded pork?
    a. Brand
    b. Co-brand
    c. Unbranded
4. Where does the consumer buy pork?
    a. Large retailer
    b. Small retailer
    c. Specialty retailer
    d. Institution
    e. Hotel
    f. Restaurant
    g. Export
5. Who do they (#4) get the product from?
    a. Packer/Processor
    b. Food service provider
    c. Distributor/wholesaler
6. Who influences their (#5) decision?
    a. Broker
    b. Other
7. Do I/we have to own the packer/processor?

8. What production system needs to be put in place to meet my customer's demands?
9. What is the organizational (legal) structure that will maximize profits?

Appendix VI. ABG Disclaimer

This study focuses on opportunities for hog farmers to become part of coordinated pork food systems. It does not evaluate the value of production-oriented systems aimed at reducing costs for the farmer. These types of systems may have value and may be worth consideration as an alternative to coordinated pork food systems.

Agri Business Group suggests significant research and a complete feasibility study be performed before investing significant capital into any new business venture. Some questions that should be asked to determine the wisdom of such an investment include:

- Does the new venture create some new value that did not exist before?
- What will this new coordinated system or vertically integrated system do better than anyone else?
- Is there room for another player in this industry?
- Does this investment really help diversify risk?

These challenging questions should be a starting point for any potential investor.